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BARCLAYS' RESPONSE TO FINANCIAL POLICY COMMITTEE OPEN CONSULTATION ON POWERS OF DIRECTION IN THE BUY-TO-LET MARKET

11th MARCH 2016

Introduction

Barclays welcomes the opportunity to comment on the Financial Policy Committee's Open Consultation on *Powers of Direction in the Buy-To-Let Market*.

We have been concerned for some time that industry methods of assessing affordability in Buy to Let (BTL) mortgages have not been as robust as those for residential mortgages. As such, we are fully supportive of the Committee's objectives to exercise more control over measures of affordability, in particular stress rates and interest cover ratios.

However, rather than just capping the amount of lending that may be done below a mandated stress rate and interest cover ratio the Committee should consider mandating minimum stress rate and interest cover ratios for <u>all</u> new BTL lending.

Summary of Barclays' Position

1. Barclays supports the FPC's request for it to have the power to place limits on maximum LTVs and stress rate / Interest Coverage Ratios (ICR) for buy to let (BTL) lending.

2. There is an immediate need to mandate minimum stress rate and ICRs for all new BTL to ensure borrowers have made adequate provision for interest rate increases, rental voids or non-payment of rent, estate agent management fees, maintenance costs and now the additional cost to investors arising from the BTL tax changes. This will also have the benefit of bringing more consistency in the treatment of owner-occupiers and investors.

3. Underwriting standards are the means to manage inherent credit risks in mortgage lending. At comparable LTV levels we view BTL mortgages as carrying more risk than a residential mortgage. This is why Barclays, and other mainstream lenders, already tend to have maximum LTV restrictions that are more restrictive for BTL than for owner-occupied mortgages.

4. Therefore, Barclays sees no immediate need to use powers to set limits on maximum LTVs for BTL. The UK market has very little BTL lending above 80% LTV and much lending above a 75% LTV only occurs when application fees are added to the loan. Should maximum LTVs be restricted then there should be an exception to allow application fees to be added to the loan.

5. If the FPC decides to limit maximum LTVs or stress rates / ICRs then Barclays would prefer this is done on a volume, rather than a value basis. This would be both easier to measure and easier to administer operationally as flows could be controlled through existing functionality in our broker booking desk.

6. The practice of assessing BTL affordability on a transaction basis i.e. based solely on the interest expense and rental income of the purchase being financed appears unique to the UK market. In other markets affordability assessments on BTL mortgages /

Investment Property Loans are based on the borrower's total income and expenditure, including living expenses and other credit commitments.

7. Any powers granted to the FPC should not be exercised in a way that prevents lenders using affordability assessments based on the borrower's full income and expenditure position provided these incorporate any minimum ICR or stress rates that may be mandated.

8. There should be few exceptions to minimum affordability standards. Any exceptions should be restricted to situations where a customer is not borrowing more money from their existing lender.

9. In particular, affordability standards on BTL mortgages should be the same for New Build and established properties. The type of property does not alter the risk to either the lender or the consumer when assessing affordability. In practice this distinction may be difficult to identify and lenders may be forced to treat all lending in the same way.

10. Traditional lending theory requires borrowers to demonstrate at least "two ways out" of any mortgage[1]. The first of these is cash flow. The second has been sale of the security property. In other words customers have been required to first demonstrate that they have sufficient surplus disposable income (cash flow) to repay their mortgage leaving repossession of the property as the second way out only should a borrower default.

11. However, in the UK most lenders currently only require BTL borrowers to demonstrate they can afford to repay interest on their loan from cash flow, not capital, when they originate a loan. The implicit assumption in underwriting this way is that eventual repayment of the capital portion of the loan will only come from sale of property.

12. More than 80% of UK BTL mortgages are interest only.

13. In contrast, residential borrowers requesting interest only mortgages are required under MCOB 11.6.2R to demonstrate they can repay both the capital ("sums advanced") and interest. Under MCOB 11.6.5R a lender "must not base its assessment of affordability on the equity in the property which is used as security".

14. Moreover, affordability assessments on residential mortgages include an assessment of the borrower's ability to meet other financial commitments such as mortgages, personal loans and credit cards as well as making suitable allowance for living expenses. BTL affordability assessments that rely solely on rent exceeding interest do not consider the customer's whole circumstances and so contain no such safeguards.

15. Stress rates used in BTL affordability assessments are significantly *lower* than those used to test affordability on residential mortgages. This is despite actual interest rates on BTL being *higher* than on residential mortgages. This implies a reliance on increases in rental income over time, which conflicts with our view of landlords as essentially price takers.

[1] Exceptions can be seen in some products such as Margin Lending for shares, which relies on automated systems to execute margin calls and Equity Release, which bases credit criteria on actuarial assessments. However, where exceptions are permitted there needs to be sound, consistent and repeatable policies and processes in place to manage risk on those products.

16. Barclays is concerned about the potential impact on BTL borrowers of a future rising interest rate environment. This is particularly so because of the practice of testing BTL affordability on a transaction basis i.e. based solely on the interest expense and rental income of the property being financed. Using lower stress rates for BTL than for owner-occupied loans and not stressing existing credit commitments appears unique to the UK market.

17. Interest Coverage Ratios also need to be re-assessed in light of the proposed tax changes, which increase the tax paid by 20% to 25% of interest cost for many taxpayers. The current norm of 125% was only designed to cover interest (100%) and voids, agents' fees and maintenance costs (25%). The tax changes imply an ICR of 145% is required.

18. A large majority of BTL landlords own just one investment property. For the most part BTL landlords look more like retail investors than business owners. As such, ensuring that affordability of a BTL mortgage is correctly assessed is as much a conduct issue as a prudential one.

Questions and Responses

Question 4.a:

Do respondents agree with the assessment that the buy-to-let market may carry risks to financial stability?

Answer 4.a:

Any form of lending, carried out on a large enough scale, may carry risks to financial stability if not properly managed and controlled. The "first way out" of any loan should be cash flow. Therefore properly assessing affordability is the key to managing and controlling these risks.

Barclays' internal risk modelling suggests that while BTL lending has better arrears rates in good economic conditions, arrears increase more rapidly than residential mortgages when economic conditions deteriorate. This is consistent across a range of LTV bands. In the 60% to 80% LTV band the relative increase is just under two times. BTL mortgage defaults are also more likely to lead to repossession[2]. This characteristic of BTL is seen in practice in Chart 4.B when the increase in BTL arrears during the last financial crisis was proportionately much higher than on residential mortgages. Consequently we believe arrears and loss volatility are higher in BTL than in residential mortgages.

This higher volatility is offset by the relatively lower LTVs offered on BTL than on residential mortgages. While the risk on BTL mortgages is higher than residential mortgages at equivalent LTVs the maximum LTVs on BTL mortgages are lower than on residential mortgages – 75% to 80% versus 90% to 95%. This was not enough to stop the spike in arrears shown in Chart 4.B though.

[2] It should be noted that lenders have put in place a range of forbearance solutions to help keep owner occupiers in their homes that may not be applied where security is held over an investment property.

The volatility in BTL can also be seen in the sharp reduction in BTL flow during the last financial crisis in Chart 3.D. Some of this was due to contraction in the supply of funding from securitisation, while some of it was also due to lenders reducing internal flow mandates for perceived riskier assets such as BTL, high LTV residential and Interest Only residential mortgages. While underlying performance of existing BTL assets at that time was satisfactory the management actions taken speak directly to how risk managers viewed these asset classes internally.

In other respects though we would question the reliance on cyclicality to prove BTL is riskier than residential mortgages. The current extended period of low interest rates and increasing rents and property prices has made BTL an attractive investment with relatively low risk. However, as rental increases taper off and interest rates rise we expect demand for BTL will also taper and market participants will then tighten their risk settings. This process is likely to be reactive rather than proactive without some measure of regulation.

Question 4.b:

If yes, do respondents believe that these are the channels through which the buy-to-let market carries risk? If no, why?

Answer 4.b:

1. *Credit risk*

LTV – Maximum LTVs available to UK BTL borrowers are less than those available for Residential and less than those available in other jurisdictions. Most of the major UK BTL lenders set a maximum LTV of 75%. Less than 4% of BTL purchases and less than 2% of BTL remortgages have an LTV greater than 80%. Reported volumes in different LTV breaks are also likely to be clustered at the lower end of each break and reflect the common practice of adding the origination fee to the loan amount.

By way of contrast the maximum LTV offered for UK residential mortgages is at least 90% and often up to 95% LTV.

In other jurisdictions we note that Australian BTL mortgages, which are fully regulated, have a maximum LTV of 80% without lenders mortgage insurance (LMI) and 95% with LMI. In New Zealand limits are placed on the amount of BTL lending over a 70% LTV in Auckland and 80% elsewhere in the country[3]. In Canada it is also possible to get a 95% BTL loan with LMI.

Viewed relative to other jurisdictions maximum LTVs are already low and the volume of BTL lending at higher LTVs in the UK appears to be minimal. Moreover, as we note in response to Question 4.c below, the use of stress rate / ICR combinations by many BTL lenders to assess affordability places an automatic brake on LTVs.

We do not believe that the current LTVs on UK BTL lending constitute a major market risk. This could change if affordability continues to be assessed solely on the transaction rather than the borrower and maximum LTVs start to creep up.

[3] http://www.rbnz.govt.nz/financial-stability/loan-to-valuation-ratio-restrictions

Diagram 1

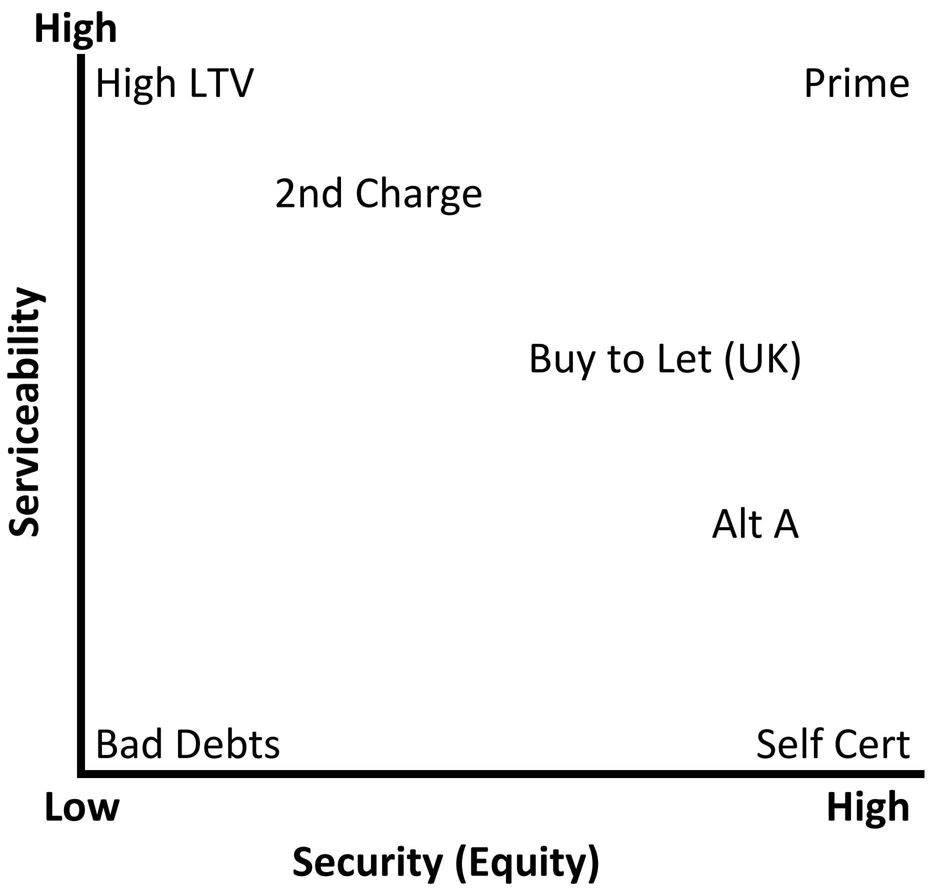

Diagram 1 above shows the relative weighting placed on security and serviceability / propensity to repay for various types of mortgage lending[4].

BTL in the UK has lower maximum LTVs relative to other markets. However, most lenders still assess BTL affordability based on the individual transaction being financed, not the borrower's complete income and expenditure[5]. Maximum LTVs on BTL are still relatively low but if LTVs were allowed to increase this would push BTL further to the left on this diagram. If lenders wish to continue assessing affordability differently to owner occupied mortgages this should continue to be offset by lower maximum LTVs than on residential.

Affordability (stress rate / ICR) – We believe the common method and settings when assessing BTL affordability based solely on a stress rate / ICR combination constitutes a market risk. More detail is provided in the answer to Question 4.c below but we note the

[4] The original diagram came from a Moody's paper issued before the last financial crisis to which we have added BTL.

[5] Barclays does complete an assessment of each borrower's full income and expenditure position including living expenses and other credit commitments.

following deficiencies in relying solely on a stress rate / ICR combination to assess affordability:

i. BTL stress rates are significantly below those used for residential mortgages.
ii. Affordability assessments for interest only BTL mortgages only require borrowers to cover interest. However, owner occupier interest only borrowers must demonstrate they have sufficient income to cover both capital *and* interest.
iii. This does not assess a borrower's full financial position. Surplus income from the BTL investment may be required to cover not just an increase in interest rates but also:
    a. Existing debts not considered in the BTL assessment, or
    b. Living expenses not provided for in the BTL assessment.
iv. The UK appears to be unique in relying on ICRs. Australia, New Zealand, Ireland and Canada all require full affordability assessments for BTL lending.
v. Anecdotally, we believe some competitors factor future rental increases into their affordability modelling. We have not been able to identify any other market that allows this and for reasons outlined below we disagree with this approach.
vi. Since the proposed tax changes for BTL borrowers were announced changes to affordability criteria have been limited to a few lenders and do not go far enough to fully offset the impact of the changes.

While there may be a temptation to wait and see what impact the changes to deductibility of BTL interest and the increase in SDLT have on the BTL market this should be resisted. The changes to deductibility of interest will have a negative impact on BTL affordability, which should be factored into lenders' affordability assessments. If the market is not prepared to factor in this impact voluntarily then it is even more important that the FPC take action to mandate minimum ICRs and stress rates.

We note that fiscal changes are already having an impact. The 'BDRC Continental; Landlords Panel' research (January 2016) suggests landlord confidence has fallen since the budget announcement and is now lower than during the 2007 financial crisis. Intentions to sell property now exceed intentions to purchase. This reflects the impact on landlords' cash flows and hence affordability that the tax changes will have.

2. *Amplification of housing market cycles*

The recent BTL tax changes increase BTL interest costs for higher rate taxpayers by 20% to 25%. Because the tax changes require gross rent to be included as income rather than net rent (after interest) the changes will also push many lower rate taxpayers into higher tax brackets. This will amplify risk on both back books and new flows (unless underwriting criteria are adjusted to compensate).

Analysis of our own BTL portfolio suggests that BTL borrowers generally maintain a healthy cash balance.[6] However, the best protection against forced sales is to ensure that the loans are affordable when originated and that borrowers have sufficient surplus income to withstand such economic shocks.

[6] This analysis is based solely on deposits held in other Barclays accounts. Borrowers could have additional cash holdings with other financial institutions

3. Interaction with high indebtedness

We note that the current methodology used by many lenders to assess affordability on BTL, based solely on a stress rate / ICR combination does not include other indebtedness in that assessment. No stress rate or ICR is applied to existing mortgages or other credit commitments. Nor do they include any assessment of the borrower's day to day living expenses.

Question 4.c:

Do respondents think that the powers requested by the FPC relating to LTV ratio limits and ICR limits would be effective in addressing any risks posed to financial stability from the buy-to-let market? If not, why?

Answer 4.c:

Interest Coverage Limits

If they are exercised the powers requested by the FPC relating to interest coverage limits address the immediate risks posed to financial stability from the buy-to-let market.

A widespread practice in the buy-to-let lending market is to use an *interest coverage ratio (ICR)* in assessing affordability. The interest rate used is generally, but not always, higher than the customer's initial pay rate[7]. This notional interest rate is referred to as either the *stress rate* or the *affordability rate*.

The ICR and the stress rate serve different purposes but should combine to ensure that there is sufficient surplus income for a single BTL transaction to be self-supporting in the event of interest rate rises, voids or other economic shocks. For example, the majority of BTL lending requires rental income to be at least 125% of mortgage interest payments when using a stress rate of 5%. Multiplied together these produce an overall affordability rate of 6.25% (5% multiplied by 125% or 1.25).

Barclays is currently using a stress rate of 5.79% and an ICR of 135%, which when multiplied together produces an overall affordability rate of 7.82% (5.79% multiplied by 135% or 1.35).

- ICR

Historically the ICR of 125% or 1.25 times has been assessed in various markets as:

8%	to cover 4 weeks potential voids or unpaid rent
8%	to cover letting agents fees
9%	for other costs and to allow a cash reserve to develop
100%	to cover the stress rate
125%	TOTAL ICR

[7] This was not always the case – see Question 4.i below.

The 125% ratio has been used successfully in various markets in different forms. In the UK it has taken the form of an ICR. In markets such as Australia and New Zealand it has taken the form of discounting rental income within a full assessment of affordability. In those two countries lenders typically take only 80% of the rental income when fully assessing a customer's affordability. The figure of 80% is the inverse of the 125% ICR used in the UK and produces the same result – 100% of rent is equal to 125% of the rent (80%) used in the affordability assessment.

In the past an ICR of 125% has worked well when assessing affordability – provided it has been paired with an appropriate stress rate. However, an ICR of 125% is now inadequate to offset both the costs outlined above and the additional cost to landlords that will be imposed by the tax changes proposed in the Summer Budget.

To the current ICR should now be added the additional tax that will be paid by landlords following the proposed tax changes:

Higher Rate Taxpayer (40%)[8]:	125%	TOTAL ICR
	20%	to cover additional tax
	145%	REVISED TOTAL ICR
Advanced Rate Taxpayer (45%):	125%	TOTAL ICR
	25%	to cover additional tax
	150%	REVISED TOTAL ICR

- Stress rate

Stress rates are set to protect lenders and consumers from potential interest rate increases. They are based on a forward view of forecast interest rate movements and as such they are generally set at a consistent margin above customers' pay rates at origination. Generally they incorporate a minimum margin above pay rates even when these are forecast to decrease – as no forecaster is infallible.

Some lenders make an exception to this rule when customers take a fixed rate product with a term of five years or more. In these cases the customer's fixed pay rate is used instead of a stress rate when applying the interest coverage ratio to determine the rental income required to pass affordability checks. This approach finds support in its acceptance for regulated mortgage contracts in MCOB 11.6.18R which says that:

> … a mortgage lender must consider the likely future interest rates over a minimum period of five years from the expected start of the term of the regulated mortgage contract (or variation), *unless the interest rate under the regulated mortgage contract is fixed for a period of five years or more from that time* … (our emphasis).

[8] Because the tax changes require gross rent to be included as income rather than net rent (after interest) the changes will also push many lower rate taxpayers into higher tax brackets. A Basic Rate Taxpayer (20%) could now have tax calculated on their BTL income at 40% and a Higher Rate Taxpayer (40%) at 45%.

It seems reasonable to also apply this approach to the (unregulated) BTL market.

We note that the same approach is also taken in both Australia and New Zealand when assessing affordability on fixed rate mortgages with terms of five or more years. This is applied on both Investment Property Loans (BTL) and Owner-Occupied mortgages.

As can be seen in Schedule “A” the stress rates applied to BTL lending are significantly less than those applied to residential lending. This is despite the fact that the pay rate on BTL loans is significantly higher than those for residential lending, as shown in Schedule “B”.

The argument that is usually advanced for this disparity is that landlords have the ability to increase rents to cover any increase in interest rate. This is not a view that Barclays is comfortable with.

Landlord interest costs are already being increased by 20% to 25% over the next four years by the proposed tax changes. To maintain the same level of surplus income that they enjoy today from their BTL property landlords will already need to consistently increase rents by 5% per annum over a period of 4 to 5 years. This is well above the rate of current market rent increases and comes before any potential increase in interest rates.

Landlords are “rent takers” and it is unrealistic to expect landlords to be passing on cost increases to their tenants over and above normal rental growth across the market. Rental growth is itself constrained by growth in wages. Wage growth is likely to be an increasingly binding constraint on landlords’ ability to raise rents.

Landlords are also constrained in the timing of any rent increases by current lease terms, which may provide for annual or even less frequent rent reviews and which may restrict any increase by reference to a pre-agreed formula such as changes in external price indices. Therefore an increase in the interest rate or tax payable today may not be recouped in higher rent charges for an extended period. Affordability assessments need to be robust enough to cater for such eventualities.

LTV Ratio Limits

The widespread practice in the buy-to-let lending market of using an interest coverage ratio (ICR) in assessing affordability already restrict LTVs on BTL mortgages as can be seen in the following examples. Before the Tax Changes were announced a BTL landlord needed much lower yields in order to obtain a 75% LTV mortgage:

- Using a (common) stress rate of 5% and Interest Coverage Ratio of 125%:
    - a rental yield of ~5.31% is required to qualify for a 85% LTV
    - a rental yield of ~4.69% is required to qualify for a 75% LTV
    - a rental yield of ~4.06% is required to qualify for a 65% LTV
    - a rental yield of ~3.13% is required to qualify for a 50% LTV

- Using a slightly higher stress rate of 5.5% and Interest Coverage Ratio of 125%:
    - a rental yield of ~5.84% is required to qualify for a 85% LTV
    - a rental yield of ~5.16% is required to qualify for a 75% LTV
    - a rental yield of ~4.47% is required to qualify for a 65% LTV
    - a rental yield of ~3.44% is required to qualify for a 50% LTV

The tax changes will increase a borrower's effective interest costs by 20% to 25%. To compensate for this the Interest Coverage Ratio lenders use should also increase:

- Using the (common) stress rate of 5% and Interest Coverage Ratio of 145%:
    - a rental yield of ~6.16% is required to qualify for a 85% LTV
    - a rental yield of ~5.44% is required to qualify for a 75% LTV
    - a rental yield of ~4.71% is required to qualify for a 65% LTV
    - a rental yield of ~3.63% is required to qualify for a 50% LTV

- Using a slightly higher stress rate of 5.5% and Interest Coverage Ratio of 125%:
    - a rental yield of ~6.78% is required to qualify for a 85% LTV
    - a rental yield of ~5.98% is required to qualify for a 75% LTV
    - a rental yield of ~5.18% is required to qualify for a 65% LTV
    - a rental yield of ~3.99% is required to qualify for a 50% LTV

The policy modelled in Scenario 2 at page 29 of the Impact Assessment will stretch yields required to achieve higher LTVs even further:

- Using a stressed interest rate of 7% and Interest Coverage Ratio of 125%:
    - a rental yield of ~7.44% is required to qualify for a 85% LTV
    - a rental yield of ~6.56% is required to qualify for a 75% LTV
    - a rental yield of ~5.69% is required to qualify for a 65% LTV
    - a rental yield of ~4.38% is required to qualify for a 50% LTV

However, it needs to be remembered that the results of that modelling were based on a period where interest costs were fully deductible. Under the new tax rules the effective interest costs of borrowers will rise by 20% to 25% for those paying marginal tax rates of 40% and 45%. Some borrowers currently paying a 20% tax rate will also be forced into a higher tax bracket because of the way the tax changes are constructed. They will need an additional buffer:

- Using a stressed interest rate of 7% and Interest Coverage Ratio of 145%:
    - a rental yield of ~8.63% is required to qualify for a 85% LTV
    - a rental yield of ~7.61% is required to qualify for a 75% LTV
    - a rental yield of ~6.06% is required to qualify for a 65% LTV
    - a rental yield of ~5.08% is required to qualify for a 50% LTV

There is some room to debate exactly where stress rates and interest coverage ratios should sit. However, it is clear that provided they are set at a level that will offset the proposed tax changes it will be much more difficult to achieve LTVs greater than 75% when assessing transactions on a standalone basis. It will only be possible for a lender to lend at these LTVs where the borrower can evidence substantial additional surplus income that is independent of the property being purchased.

Question 4.d:

Do respondents agree that the FPC should be granted powers of direction over LTV ratio limits and ICR limits? If not, why?

Answer 4.d:

Yes. See also question 4.c above. Provided stress rates and interest coverage ratios are set at appropriate levels to offset the proposed tax changes it will be difficult, if not impossible, to offer LTVs greater than 75% on a standalone basis. Given current rental yields we would expect BTL affordability assessments calculated on a standalone basis will not permit LTVs greater than ~66% in most regions. The only way to extend higher LTVs will be to assess BTL mortgages on a full income and expenditure basis where customers have substantial surplus personal income from other sources such as salary.

For that reason we believe powers of direction over LTV limits, although required, may not need to be exercised.

To the extent that current stress rates and interest coverage ratios do not yet reflect the proposed tax changes and relative margins vis-à-vis residential stress rates there is a clear case for powers of direction over BTL stress rates and ICRs.

Question 4.e:

Are there any alternative options for addressing risks posed to financial stability from the buy-to-let market that the government should consider?

Answer 4.e:

No. However, Barclays has taken a view that BTL will eventually be fully regulated. As far as possible when making changes, such as for the Mortgage Credit Directive, we are building systems and processes that treat residential and BTL mortgages the same.

This view we have taken of the likely future direction of regulation in the BTL market has been informed by the following observations:

1. A large majority of people borrowing to invest in BTL are not operating a business but rather use BTL as a savings or investment vehicle, and
2. A large majority of people borrowing to invest in BTL have only one rental property.

If you take the view, as Barclays has, that the majority of people borrowing to invest in BTL investors are consumers rather than businesses then it follows that they should receive the same protections as other consumers. Ensuring the proper assessment of affordability becomes a conduct issue as well as a prudential issue when looked at through this lens.

Question 4.f:

Do respondents agree with the definition and scope of buy-to-let lending for the purpose of the FPC's powers of direction? If not, why?

Answer 4.f:

We support the industry response on this issue provided by the CML.

Question 4.g:

Should any activities associated with buy-to-let lending be excluded from that definition (including the current exclusion of new-build housing)? If so, why?

Answer 4.g:

No, there should be no exclusions. While there may be good reasons to encourage growth in the number of new dwellings built this should not come at the expense of sound lending standards. We note the following characteristics of New Build that may create *greater* risk for a lender:

a) New build properties typically carry a price premium for "newness" relative to comparable second hand properties. Once occupied the property becomes second hand and the price premium disappears.

b) Similarly, new build properties can achieve higher initial rental income than a comparable second hand property but this premium can also quickly wear off.

c) Re-sales in new build developments have to compete with new stock continuing to come onto the market and generally sell at a discount to the price of new stock.

d) Large scale new build developments create issues of concentration risk for lenders.

e) When multiple new build developments come onto the market at the same time they compete with each other for sales and tenants. Re-sales in new build developments can suffer from oversupply.

f) Service charges on New Build properties are higher than on established properties and can create a hidden cost for landlords.[9]

[9] http://www.cityam.com/236431/uk-house-prices-service-charges-for-new-build-properties-are-double-those-of-older-homes

Question 4.h:

Do respondents agree that the FPC should be able to apply LTV and ICR limits to a proportion of new mortgages calculated on either a value or volumes basis? If not, please explain on which basis the tools should apply and why.

Answer 4.h:

Yes. However, if the FPC decides to limit maximum LTVs or stress rates / ICRs then Barclays would prefer this is done on a volume, rather than a value basis. This would be both easier to measure and easier to administer operationally as flows could be controlled through existing functionality in our broker booking desk.

The power to apply an ICR / stress rate limit, whether calculated on either a value or volumes basis, should apply to all new BTL mortgages as a minimum affordability standard across the industry. Setting minimum stress rates and ICRs across all new lending will provide more transparency and avoid distortions in the market place.

The FPC may also choose to set different criteria for more specialised lending such as for Houses in Multiple Occupation (HMO) or student accommodation if these are assessed to be riskier. Although Barclays does not participate in the licensed HMO market we note that lenders who do already apply higher ICRs and stress rates to these loans, presumably because they perceive these loans to be riskier.

Question 4.i:

Do respondents agree with the government's proposed approach in relation to re-mortgages and further advances on existing mortgages? If not, please describe an approach that would be more suitable.

Answer 4.i:

Partially. Where a customer conducts a post contract variation with their existing lender and does not borrow any more money that lender should be permitted to assist their customer. There is no additional risk involved and it would be unreasonable not to assist.

However, if further borrowing is required this should be assessed based on a minimum affordability standard. The debt, and potential risk, has increased. Provision should be made for exceptions where lenders may need to protect the value of their security, e.g. where urgent repairs are required.

Similarly, if a customer is remortgaging with another lender that lender should also assess that loan based on the same minimum affordability standard. The new lender is accepting a risk that they did not have previously.

As least as late as 2013 loans affordability was being assessed by some lenders using short term (less than five years) pay rates to assess affordability. Forcing these loans that were previously assessed using lower standards of affordability to be reassessed using more suitable stress rates will gradually wash this risk out of the system. It will also encourage borrowers to pay down existing debts and achieve healthier gearing ratios.

Question 4.j:

Do respondents agree with the government's proposed approach in relation to procedural requirements? If not, please describe an appropriate approach.

Answer 4.j:

We support the industry response on this issue provided by the CML.

Question 4.k:

Do respondents agree that the government's approach to buy-to-let debt and income in relation to the FPC's owner-occupier housing tools remains appropriate?

Answer 4.k:

Yes.

Question 5.a:

Do respondents have any comments on the draft statutory instrument?

Answer 5.a:

The instrument essentially does what it sets out to do in providing the Financial Policy Committee with the power to direct the PRA or FCA to require regulated lenders to allow no more than a specified portion of loans over a specified maximum LTV percentage or a minimum interest coverage ratio.

We suggest that that "relevant buy-to-let mortgage contracts" (referred to in the macro prudential measures) should be a defined term.

Question 6.a:

Do respondents have comments on the analysis in this impact assessment?

Answer 6.a:

More analysis in some areas would have been beneficial. For example:

a) Including comparisons with larger markets such as Australia and Canada – both the Ireland and New Zealand markets are relatively small.
b) Calling out any differences between the UK and other BTL markets in comparisons – both the Ireland and New Zealand markets are quite different to the UK.

c) Segmenting the market and considering the potential impacts on sub-segments such as the High Net Worth (HNW) market, Consumer Buy to Let under MCD, Houses in Multiple Occupation (HMOs), student accommodation and holiday lets.
d) Examining the actual credit performance in markets that already require lenders to consider all of a borrower's income and expenditure when assessing affordability.
e) Impacts on related small businesses that service the BTL market.
f) Impacts on workforce mobility if rents increase and / or availability of rental accommodation increases.

Question 6.b:

Do respondents have views on the assumptions underpinning this impact assessment?

Answer 6.b:

See 6.a above.

Question 6.c:

Do respondents have comments on the impact on small and micro businesses in this impact assessment?

Answer 6.c:

See 6.a above.

Question 6.d:

Do respondents agree with the estimates of the costs of data collection?

Answer 6.d:

We are unable to fully assess the cost until full data requirements are clear.

We note that potential additional recording and documentation within the application process in order to fulfil reporting requirements has not been considered. This includes any additional cost in time for advisors and brokers (or customers) during the application process.

SCHEDULE "A" – COMPARISON OF MARKET STRESS RATE / INTEREST COVERAGE RATIO COMBINATIONS[10] AT 9 MARCH 2016					
Lender	**Minimum rental cover (ICR)**	**Calculation basis:**	**Stress Rate * ICR**	**Residential stress rate**	**Difference[11]**
Lender 1	125%	5% or pay rate (if higher) fixed over 3 years	6.25%	7.35%	1.10%
	125%	6% or pay rate (if higher) trackers and fixed rates under 3 years	7.50%	7.35%	-0.15%
Barclays	135%	5.79%	7.82%	6.99% or 7.24%	-0.58%
Lender 2	125%	<=65% LTV: 5.00% or pay rate	6.25%	7.50%	1.25%
	125%	>65% LTV: 5.50% or pay rate	6.88%	7.50%	0.62%
Lender 3	125%	4.99% for LTV <=65%	6.24%	6.99%[12]	0.76%
	125%	5.49 for LTV >65%	6.86%	6.99%	0.14%
Lender 4	125%	5.99%	7.49%	7.49%	0.00%
Lender 5	125%	<=65% LTV: 4.99% or pay rate	6.24%	6.99%	0.75%
	125%	>65% & <=75% LTV: 5.49% or pay rate	6.86%	6.99%	0.13%
	125%	>75% LTV 5.99% or pay rate 4.99% stress rate for product terms of 5 or more years (for any LTV)	7.49%	6.99%	-0.50%
Lender 6	125% - Single Units	5% or product rate - Individuals	6.25%	N/A	N/A
	125% - Single Units	5% or product rate - Limited Companies	6.25%	N/A	N/A
	130% - Multi units	7% or product rate	9.10%	N/A	N/A
Lender 7	125%	5.50%	6.88%	7%	0.13%
Lender 8	125%	5.5% above 60%	6.88%	6.5%+7%	0.13%
	125%	5% up to 60%	6.25%	6.5%+7%	0.75%
Lender 9	125%	6.00%	7.50%	6.99%	-0.51%
Lender 10	125%	<= 65% Higher of product rate or notional rate, currently 5%	6.25%	7.00%	0.75%

[10] Moneyfacts Analyzer and lender websites (see below)
[11] How much higher (or lower) is a particular lender's stress rate on owner-occupier loans than on BTL
[12] Estimated minimum only – based on 3% over current reversion rates

SCHEDULE "B" – COMPARISON OF BTL AND RESIDENTIAL MORTGAGE RATES[13] AS AT 3 MARCH 2016

Lender 11	125%	The higher of 5.99% or pay rate	7.49%	SVR +3%	0.00%
Lender 12	125%	5.24% or pay rate	6.55%	7.00%	0.45%

[13] Moneyfacts Analyzer

Resi 60%				BTL 60%				
Provider	**Rate**	**Highest Rate**	**Product fee notes**	**Rate**	**Highest Rate**	**Product fee notes**	**Differential: BTL v Residential**	**Differential: Highest BTL v Residential**
Lender 1	1.69	3.09	Arrangement £999, Completion £295	3.19	3.39	Arrangement £995, Completion £295	1.50	0.30
Lender 2	1.49	1.49	Booking £749	2.19	3.19	Booking £1797	0.70	1.70
Lender 3	1.79	2.99	Arrangement £995, Completion £295	3.39	3.59	Arrangement £995, Completion £295	1.60	0.60
Lender 4	1.74	2.54	Booking £995	2.18	3.23	Arrangement £1995	0.44	0.69
Lender 5	1.74	2.54	Booking £995	2.18	3.23	Arrangement £1995	0.44	0.69
Lender 6	1.59	1.99	Booking £995	1.99	2.94	Booking 1.50% Advance	0.40	0.95
Lender 7	1.70	2.17	Completion £995	2.09	3.19	Completion £1995	0.39	1.02
Lender 8	1.49	2.89	Arrangement £1995, Completion £265	2.59	3.14	Arrangement £1995, Completion £265	1.10	0.25
Barclays	1.59	1.95	Arrangement £999	2.19	2.99	Arrangement £1999	0.60	1.04

Res 75%				BTL 75%				
Provider	**Rate**	**Highest Rate**	**Product fee notes**	**Rate**	**Highest Rate**	**Product fee notes**	**Differential: BTL v Residential**	**Differential: Highest BTL v Residential**
Lender 1	1.94	2.84	Arrangement £1499, Completion £295	4.09	4.29	Arrangement £995, Completion £295	2.15	1.45
Lender 2	1.49	1.99	Booking £1499	2.79	3.69	Booking £1797	1.3	1.7
Lender 3	2.29	2.94	Arrangement £995, Completion £295	4.29	4.49	Arrangement £995, Completion £295	2	1.55
Lender 4	1.97	2.63	Booking £995	2.73	3.84	Arrangement £1995	0.76	1.21
Lender 5	1.97	2.63	Booking £995	2.73	3.84	Arrangement £1995	0.76	1.21
Lender 6	1.64	2.2	Booking £1495	2.49	3.64	Booking 1.50% Advance	0.85	1.44
Lender 7	1.84	2.24	Completion £995	2.78	3.72	Completion £1995	0.94	1.48
Lender 8	1.74	2.29	Arrangement £1995, Completion £265	3.34	3.69	Arrangement £1995, Completion £265	1.6	1.4
Barclays	1.73	2.39	Arrangement £499	2.54	3.69	Arrangement £1999	0.81	1.3

SCHEDULE "C" – COMPARISON OF BTL UNDERWRITING CRITERIA BY COUNTRY				
	UK	**Australia**	**New Zealand**	**Canada**
ICR / Rent Discount	125%[14]	80%	80%	50% to 70%
Maximum LTV[15]	75% - 80%	80% 95% with LMI[16]	Auckland[17]: 5%>70% Non-Auckland: Max: 15%>80%	80% 95% with LMI
Stress Rate vs Residential	Lower	Same	Same	Same
Full Income & Expenditure	No	Yes	Yes	Yes
Basis of Assessment	Interest Only or C&I per loan type	All C&I	All C&I	All C&I

[14] 125% ICR is the inverse of the 80% discount applied to rental income in Australia and New Zealand. The net impact is the same.

[15] Since 2015 only 10% of buy-to-let mortgages in Ireland may exceed an LTV ratio of 70%.

[16] Lenders Mortgage Insurance

[17] I.e. No more than 5% of BTL lending in the Auckland Council area can have an LTV >70%. Outside this area no more than 15% of BTL lending can have an LTV >80%.